

Central Intelligence Agency



Washington, D. C. 20505

## DIRECTORATE OF INTELLIGENCE

22 NOVEMBER 1982

East Germany's Financial SituationSummary

East Germany remains vulnerable to a liquidity crisis next year, but should pull through if it is able to run a current account surplus at least as large as this year's and does not suffer a further reduction in Western credits. The domestic economy, however, is straining to generate a resource outflow to the West after years of large current account deficits. Nonetheless, the leadership appears unwilling to adopt a long-term adjustment strategy and is relying on tighter central control to manage its difficulties.

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This memorandum was prepared by [redacted] East European Division, Office of European Analysis. It was requested by Robert Cornell, Deputy Assistant Secretary for Trade and Investment, US Department of State. Comments and questions are welcome and should be directed to [redacted] Chief, East European Division, Office of European Analysis, [redacted]

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The East German financial position weakened markedly early this year in the wake of the general cutback in bank lending to Eastern Europe. Data from the Bank for International Settlements (BIS) show that Western banks reduced their exposure by nearly \$1 billion during the first quarter, forcing the East Germans to drawdown their reserves by about \$600 million to cover maturing obligations. East Germany suffered a further \$400 million loss in credit lines during the second quarter but was able to halt the loss of reserves. BIS statistics do not reflect East German financial activities with West Germany, about which we have scant information. [REDACTED]

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The regime reacted to the credit squeeze by enacting a number of measures to slash imports of feedgrains, luxury consumer items, and spare parts and further encourage the export of virtually all marketable goods. Imports from the West dropped by about 10 percent in the first half of the year, according to IMF data, while exports grew by 7 percent. Additional government efforts later in the year to cut imports and push exports underpin our judgment that East Germany could record an \$800 million hard currency trade surplus this year and move its current account into surplus by \$475 million. [REDACTED]

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Western banks differ in their assessments of East Germany's creditworthiness. Some bankers, fearful of a financial crisis early next year, have told US officials that they plan to continue reducing exposure, but bankers talking to Embassy East Berlin apparently still regard the economy as basically sound

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despite its \$13-14 billion debt and 63 percent debt service ratio. In discussions with US officials some bankers point to punctual East German debt service payments as proof that the situation is under control. Nonetheless, we estimate that at best East Germany will be able to roll over only \$3.8 billion of its \$5.3 billion in maturing credits and will have to draw down reserves by over \$1 billion to cover its financing gap this year. [REDACTED]

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We project that next year's financing requirement will fall to \$3.6 billion largely because this year's cutback in lending will reduce debt repayment obligations. This projection also assumes that East Germany can raise exports slightly above this year's level while holding imports at the 1982 level and that lower interest rates will reduce debt servicing costs by about \$200 million. If it is to cover this requirement, East Germany cannot suffer a further substantial loss in Western credits since it will have a much smaller cushion of reserves. It is still vulnerable to any decline in banker confidence that would result in a rapid outflow of its still large short-term debt. [REDACTED]

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East Germany's efforts to deal with its external financial constraints through import cuts and an export drive are having an increasingly severe impact on the domestic economy. According to East German statistics the growth of national income slowed to an annual rate of 3 percent in the first half of 1982, down from last year's 5 percent rate. Continuing import restraints suggest that full year growth will probably fall to less than half of this year's target of 5 percent and that next year's objectives

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will not be met either. The US Embassy in East Berlin reports that consumer supplies appear to be deteriorating; according to the US Mission in West Berlin, the West German government suspects that formal rationing could be introduced before long.

[REDACTED]

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The regime's response to its financial problems has been to adopt quick-fix solutions--no matter what the cost to the economy--and to avoid formulation of a long-term adjustment strategy. Unlike some other East European countries, there appears to be no movement toward introduction of market forces into the economy. Indeed the leadership seems intent on relying solely on tighter central control in order to master the current liquidity squeeze.

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Statistical Note

Contradictions between East German and Western partner trade data, as well as the lack of basic data on West German-East German credit flows, force us to be quite cautious about our projections for East Germany. For the first time since the mid-1970s, East Germany released statistics on its exports and imports with nonsocialist countries for 1980-81. (The CEMA handbook, which has regularly reported East German trade with the West, has not yet been published for 1981.) The new East German statistics show that East Germany's trade balance with the non-socialist area moved from a \$1.8 billion deficit in 1980 to a \$60 million surplus last year as a result of a 4 percent fall in imports and a 28 percent gain in exports. IMF Direction of Trade statistics plus inner-German trade data, on the other hand, show the deficit declining from \$430 million in 1980 to \$240 million last year due to a 5 percent decline in exports and an 8 percent fall in imports. Our estimate for the 1981 trade deficit accepts the East German import total of \$7.1 billion, but we have increased exports by only 7 percent over 1980 to \$6.3 billion. This yields a trade deficit of \$800 million, which appears consistent with known net credit flows from the West.

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Banks in West Germany do not report their assets and liabilities with East Germany to the BIS. The Inner-German Affairs Ministry regularly reports the net accumulated debt arising out of inner-German trade. We believe, however, that this total does not include credits from West German banks that

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[REDACTED]

are not related to West German-East German trade. Because West German banks have been providing non-trade related financing since at least the mid-1970s, East Germany's debt to West Germany is almost certainly greater than the announced totals. [REDACTED]

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East Germany: Estimated Financing Requirement 1981-83  
(millions US \$)

	<u>1981</u>	<u>1982</u>	<u>1983</u>
<u>Financing Requirement</u>	<u>6065</u>	<u>4825</u>	<u>3600</u>
Current Account Balance	-1315	475	850
Trade Balance	- 800	800	900
Exports	6300	6900	7000
Imports	7100	6100	6100
Net Invisibles, excluding interest	985	1075	1150
Net Interest	-1500	-1400	-1200
Repayments of Short-term Debt	-2500	-2350	-1750
Repayments of M/LT debt	-2250	-2950	-2700
 <u>Borrowing Sources</u>	 <u>5750</u>	 <u>3800</u>	
Medium and long-term credits	3200	2050	
Short-term Credits	2350	1750	
Error and Omissions	350	0	
Change in Reserves	35	-1025	
Reserves	2585	1560	
In BIS reporting banks	2185	1385	
In West German banks (estimated)	400	175	

East Germany: Debt Statistics (end-June 1982)

	<u>1982</u> (billion dollars)
<u>Total Gross Debt</u>	13.6
<u>Maturity</u>	
Short-term	1.9
Medium and long-term	11.7
<u>Distribution</u>	
Official (excluding West Germany)	2.5
Private (non-guaranteed excluding West Germany)	9.4
Inner-German debt	1.7 <sup>a</sup>

<sup>a</sup> Estimated gross debt differs from West German officially reported figure for accumulated net deficit on inner-German trade of \$1.4 billion (DM 3.4 billion) because it has not been adjusted for the estimated \$300 million in East German assets in West German banks.



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Western Creditor Exposure to East Germany  
(billion US \$)

Western Government Commitments of Both  
Principal and Interest (end-1981)

<u>Total</u> <sup>a</sup>	<u>6.5</u>
Austria	1.4
France	1.4
FRG	1.0
Italy	0.3
Japan	1.2
Netherlands	0.1
Switzerland	0.2
UK	0.2
Other	0.7

Western Bank Claims (excluding West Germany;  
including guaranteed claims as of 30 June 1982)<sup>b</sup> 8.8

Of which	
UK (Total)	(1.7)
(unguaranteed)	(1.6)
US (unguaranteed)	(0.9)

<sup>a</sup> Totals for all countries except West Germany are taken from Berne Union statistics. West German commitments, which cover principal only, are estimated from NATO credit statistics.

<sup>b</sup> Bank for International Settlements statistics.